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October 27, 2015

Kevin M. McCarty
Chair, ComFrame Development and Analysis (G) Working Group
National Association of Insurance Commissioners
Via e-mail to: rworkman@naic.org

Re: *Group Capital Calculation Recommendation*

Dear Commissioner McCarty:

On behalf of the American Academy of Actuaries'[1] Solvency Committee, I would like to offer the following comments on the *Group Capital Calculation Recommendation* ("the Recommendation") that was recently exposed by the National Association of Insurance Commissioners' (NAIC) ComFrame Development and Analysis (G) Working Group (CDAWG).

As detailed in the Solvency Committee's comments[2] on the July 2015 *Discussion Draft on Approaches to a Group Capital Calculation* and the November 2014 *U.S. Group Capital Methodology Concepts Discussion Paper*, we strongly recommend that the NAIC pursue a hybrid approach to a group capital calculation, including both a factor-based component, like the proposed risk-based capital (RBC) methodology, and a stress testing methodology, as appropriate.

While we appreciate and support the language in the Recommendation suggesting that consideration be given to the use of stress testing as a complement to a group capital calculation, we believe that this concept should be incorporated explicitly in the recommended charge to the Financial Condition (E) Committee. To that end, we urge CDAWG to amend the recommended charge as follows (new text underscored):

> ***"Construct a U.S. group capital calculation using <u>a hybrid of</u> an RBC aggregation methodology <u>and a stress testing component</u>; liaise as necessary with the ComFrame Development and Analysis (G) Working Group on international capital developments and consider group capital developments by***

[1] The American Academy of Actuaries is an 18,000+ member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

[2] http://actuary.org/files/Solvency_Comments_NAIC_Capital_Standards_080715.pdf
http://actuary.org/files/SolvencyCommittee_CapitalMethodologyConceptsComments_120514.pdf

> ***the Federal Reserve Board, both of which may help inform the construction of a U.S. group capital calculation."***

As we have noted previously, factor-based approaches like RBC are useful regulatory tools, but also have significant limitations. For example, it is not practical to expect that factors can be designed to take account of every nuance of risk across insurers. In contrast, a stress testing approach can be calibrated to an insurer's actual risks. The stress testing approach, of course, has its own disadvantages. Comparable results could be elusive where risks differ dramatically from insurer to insurer and use of models requires significant resources from both regulators and insurers.

The Solvency Committee strongly supports a hybrid approach because it offers a potential path that draws the best features from RBC and stress testing methodologies. For example, state regulators could use an RBC methodology to establish a minimum required level of capital that applies to all U.S. insurers. A stress testing methodology could then be used to establish a prudent capital level above this minimum. Such an approach could maximize the advantages of each methodology while minimizing the disadvantages. In addition, a well-designed RBC-based minimum could give regulators the flexibility to design a stress testing or similar prudent capital methodology that takes adequate account of the significant economic differences between life insurers and property and casualty insurers.

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Thank you for this opportunity to provide our views on the CDAWG's group solvency and capital calculation recommendation. If you have any questions or would like to discuss this letter in more detail, please contact Nikhail Nigam, the Academy's legislative assistant, at 202.223.8196 or nigam@actuary.org.

Sincerely,

Elizabeth K. Brill, MAAA, FSA
Chairperson, Solvency Committee
Risk Management and Financial Reporting Council
American Academy of Actuaries

cc: Michael McRaith, Director, Federal Insurance Office, U.S. Department of Treasury
Tom Sullivan, Senior Adviser for Insurance, Federal Reserve Board
Jeff Schlinsog, Chair, Financial Regulatory Task Force, Risk Management and Financial Reporting Council, American Academy of Actuaries